Robert T. Stephan
Attorney General of the State of Kansas
Kansas Judicial Center, 2nd Floor
10th and Harrison
Topeka, Kansas 66612
(913) 296-2215

QUESTION PRESENTED

Whether there is evidence of a federal policy of allowing the States to use the worldwide combined report accounting method so as to remove these cases from a Dormant Commerce Clause analysis.

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES: Page

CONSTITUTIONAL PROVISIONS:

STATUTES:

TABLE OF AUTHORITIES

MISCELLANEOUS: Page

TABLE OF AUTHORITIES

MISCELLANEOUS: Page

TABLE OF AUTHORITIES

MISCELLANEOUS: Page

Nos. 92-1384 and 92-1839

In The
Supreme Court of the United States
October Term, 1993

BARCLAYS BANK PLC,
Petitioner,
vs.
FRANCHISE TAX BOARD,
An Agency of the State of California,
Respondent.

COLGATE-PALMOLIVE COMPANY,
Petitioner,
vs.
FRANCHISE TAX BOARD,
An Agency of the State of California,
Respondent.

On Writs of Certiorari to the Court of Appeal of the State of California in and for the Third Appellate District

---

BRIEF OF AMICI CURIAE IN SUPPORT OF RESPONDENT FRANCHISE TAX BOARD BY THE STATE OF NORTH DAKOTA AND THE STATES OF HAWAII AND KANSAS

INTEREST OF AMICI CURIAE

Amici are States which compute the tax liabilities of multijurisdictional business under the "unitary business

principle." Amici have a direct interest in the question of when this Court's dormant Commerce Clause analysis applies and when actions of the Legislative and Executive Branches of the Federal Government establish that a State tax is permitted.

In 1986, this Court broke new ground in the analysis of State taxes under the Commerce Clause in its decision in *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986). This Court applied that decision again in the 1992-93 term in *Itel Containers International Corp. v. Huddleston*, 507 U.S. ___ (1993), 122 L.Ed.2d 421. Amici have a continuing interest in the application of *Wardair* and *Itel* to State taxes.

STATEMENT PURSUANT TO RULE 37

This brief is submitted pursuant to Rule 37.3 of this Court in support of Respondent, Franchise Tax Board, State of California. Consent to the filing of this brief has not been requested from the parties because the amici filing this brief are the Attorneys General of their respective States. Rule 37.5.

SUMMARY OF ARGUMENT

This Court's decision in *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986), establishes a framework to evaluate whether the actions of the Legislative and Executive Branches of the Federal Government permit a State tax law.

The Federal Government's actions in the circumstances of this case evidence a federal policy permitting the State tax at issue in these cases. Congress has considered the issue of worldwide combined reporting and the United States Senate has rejected a treaty prohibition on this tax practice. In addition, the Executive Branch, by its actions, has permitted worldwide combined reporting.

California's use of worldwide combined reporting (hereinafter referred to as WWCR) should be affirmed.

ARGUMENT

IT IS THE POLICY OF THE FEDERAL GOVERNMENT, DRAWN FROM FEDERAL LAW, TO PERMIT THE STATE TAXES HERE AT ISSUE

In *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986), the Court found the Federal Government's policy, reflected by government action and inaction, was to affirmatively permit sales taxes imposed on aviation fuel used by foreign airlines in international travel. Based upon this finding, the Court determined that a dormant Commerce Clause analysis, and specifically the "one voice" element, was inappropriate. "It would turn dormant Commerce Clause analysis entirely upside down to apply it where the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow." (Court's emphasis.) 477 U.S. at 12.

Wardair provides guidance on the factors to be considered by courts when determining United States policy regarding state taxation. The Court analyzed three items: 1) the Chicago Convention on International Civil Aviation; 2) a Resolution adopted by the International Civil Aviation Organization, an organization of which the United States is a member; and 3) 70 bilateral agreements entered into by the

United States with other foreign governments.[1] With respect to these items, the Court held:

1. The Chicago Convention "precludes the imposition of local taxes on fuel only when the fuel is 'on board an aircraft . . . on arrival . . . and retained on board on leaving' . . . it does not prohibit taxation of fuel purchased." *Ibid.* The Court also stated that the provision demonstrated "awareness of the problem" and a decision to "address the problem by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority." *Ibid.*

2. The Resolution did not establish United States policy because even though it was the "work product of an international organization of which the United States is a member; it has not been specifically endorsed, let alone signed, entered into, agreed upon, approved, or passed by either the Executive or Legislative Branch of the Federal Government." *Id.* at 11.

3. The 70 bilateral agreements explicitly "commit[ted] the United States to refrain from imposing national taxes on aviation fuel" but in none of the "agreements has the United States agreed to deny the States the power" to tax. *Ibid.* This omission was interpreted by the Court as "a policy choice by the contracting parties, especially in light of the . . .

[1] The bilateral agreements involved were Executive Agreements and did not qualify as treaties. Therefore, the agreements were not subject to the advice and consent of the United States Senate.

Resolution." *Ibid.* Finally, the Court found that the "course of conduct suggests that the parties to the Agreement and those most immediately affected by it understood it to permit this sort of taxation." *Id.* at 12.

Applying *Wardair*, United States policy will be determined by considering the following factors:

1. Awareness of a problem and a decision to address the problem by curtailing some elements of authority while implicitly preserving other elements of that authority. *Id.* at 10.

2. The adoption of a policy at the national level, while excluding subnational jurisdictions from the policy. *Id.* at 11.

3. A course of conduct suggesting that the taxation involved was understood and permitted. *Id.* at 12.

Applying these evidentiary factors to Legislative and Executive Branch actions establishes that it is federal policy to permit the States to use WWCR.

A. The Actions Of Congress Are Evidence Of A Policy Of The Federal Government To Permit The State Taxes Here At Issue

1. Congressional hearings prior to the consideration of the United States/United Kingdom Tax Convention

Prior to the United States/United Kingdom Income Tax Convention, Congress studied and considered the States' use of WWCR and took no action. The Court's decision in

Northwestern States Portland Cement Company v. Minnesota and *Williams v. Stockham Valves & Fittings, Inc.*, 358 U.S. 450 (1959), prompted Congress to quickly enact Public Law 86-272. Public Law 86-272 established a minimum jurisdictional standard for the imposition of State income taxes and "initiated a comprehensive study of all matters pertaining to the taxation of income derived from interstate commerce. . . ." *State Taxation of Interstate Commerce: Report of the Special Subcommittee on State Taxation of Interstate Commerce, Committee on the Judiciary, House of Representatives*, 88th Cong., 2d Sess. (1964), Vol. 1, p. 8.

The Subcommittee, chaired by Representative Willis, conducted its study and hearings over several years. The results of this study are contained in five separate volumes and total over 2,600 pages of text and appendices. *State Income Taxation of Mercantile and Manufacturing Corporations: Hearings before the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary House of Representatives*, 86th and 87th Cong. (1961-1962) and *State Taxation of Interstate Commerce: Report of the Special Subcommittee on State Taxation of Interstate Commerce, Committee on the Judiciary, House of Representatives*, 88th and 89th Cong., 1st and 2d Sess. (1964-1965), Vol. 1-4. Two of the issues considered by the Subcommittee are whether States should be allowed to use combined reporting and whether States should be able to consider income and activities reported as being outside of the United States. No legislation was enacted as a result of these hearings, study, or report.

Additional hearings on specific bills were held by the same Subcommittee in 1966. *Interstate Taxation Act, H.R.*

11798 and Companion Bills: Hearings before the Special Subcommittee on State Taxation of Interstate Commerce of the Committee of the Judiciary, House of Representatives, 89th Cong., 2d Sess. (1966). The reports of these hearings total over 1,800 pages. The subject matter of these bills was State tax practices with regard to interstate and foreign businesses, limitations on State use of combined reporting, and inclusion of the income and activities of foreign incorporated entities. None of these bills were enacted.

Similar hearings were held in 1973, *State Taxation of Interstate Commerce: Hearings before the Subcommittee on State Taxation of Interstate Commerce of the Committee on Finance, United States Senate*, 93rd Cong., 1st Sess. (1973).

The extensive studies undertaken by House and Senate committees demonstrate an awareness of the problems associated with the States' use of WWCR. The only action taken by Congress with respect to these concerns was the passage of Public Law 86-272. Because Congress did not adopt any other legislation, despite years of direct consideration of the "problems," Congress implicitly preserved other aspects of State tax authority.

2. Senate Consideration of the United States/United Kingdom Income Tax Convention

In 1975, the Executive Branch concluded discussions with the United Kingdom on a renegotiation of the bilateral Income Tax Convention. The revisions to the Treaty included a provision, proposed Article 9(4), which would have applied to subnational taxation. Proposed Article 9(4) would have prevented States from considering the results and activities of entities organized outside of the United States which were

owned and controlled by United Kingdom organized corporations.

In the Senate Committee on Foreign Relations Hearings on the United States/United Kingdom Tax Treaty held in July of 1977, one of the principal items of focus was the proposed Article 9(4). *Tax Treaties with the United Kingdom, the Republic of Korea, and the Republic of the Philippines: Hearings before the Senate Committee on Foreign Relations*, 96th Cong., 1st Sess. (1977). Stip. ¶ 37c, BJA-24.[2]

In June of 1978, the proposed United States/United Kingdom Tax Convention (US/UK Tax Convention) was presented to the Senate for its advice and consent. During the debate on the proposed treaty, Senator Frank Church presented a reservation, the Church reservation,[3] to the treaty which would revise the provisions of proposed Article 9(4) so that it would not apply to State taxes and would not prohibit the States from using WWCR. The Senate debated the issue of whether this reservation should be attached to the treaty with respect to Article 9(4) and whether the Senate should give its advice and consent to the Convention with Article 9(4) as proposed on June 22 and June 23, 1978. Ex. 36C, BJA-238 and Ex. 36D, BJA-311.

On June 23, 1978, the Senate voted on whether it should give its advice and consent to the Convention with Article 9(4) as proposed by the Executive Branch. The recorded vote was 49 yeas and 32 nays.[4] Ex. 36D, BJA-311 at 393-394. The

---

[2] References to BJA are to the Joint Appendix in *Barclays*.

[3] So named because its sponsor was Senator Frank Church of Idaho.

[4] Senator Muskie, who was present and had voted against the treaty, withdrew his vote because Senators Bentsen and Long were not present but (continued...)

Senate is required to give its advice and consent to a treaty by a vote of two-thirds of the members present. (U.S. Const., art. II, § 2, cl. 2.) The Senate had thus refused to give its advice and consent and the treaty with proposed Article 9(4) was not ratified.

On June 27, 1978, the Senate again voted on whether to give its advice and consent to the proposed United States/United Kingdom Tax Convention, this time with the Church reservation included. The Senate's advice and consent was then given by a vote of 82 yeas and 5 nays. Ex. 36D, BJA-311 at 409-410.

These actions, when analyzed in relation to the factors considered in *Wardair*, clearly evidence a federal policy to allow the States to apply WWCR.

The history of the consideration of the US/UK Tax Convention demonstrates an acute awareness of the "problem." The Senate, by declining to give its advice and consent to the treaty, dealt with one element of the "problem" by restricting the use of WWCR for national taxation and remained silent as to the other element, subnational taxation. It dealt with the entire "problem" in unequivocal terms.

The second *Wardair* factor considers adoption of a national policy without concurrent adoption of a subnational policy. Except as to discrimination, all United States Income Tax Conventions are limited in their coverage to national taxes. See for example, Article 2, "Taxes Covered." United

---

[4](...continued)
would have voted aye. Additional votes which were announced for absent members would have increased the final vote to 54 yeas and 34 nays. Ex. 36D, BJA-311 at 392-394.

States/United Kingdom Tax Convention, Ex. 40GG, BJA-444 at 445 et seq. In the circumstance of the US/UK Tax Convention, the question of whether subnational taxes should be accorded national treatment was presented and rejected by the U.S. Senate.

The Senate's consideration of the US/UK Tax Convention satisfies the *Wardair* factors. The Senate's course of conduct conclusively established that the Senate, and all other parties involved, understood and permitted the use of WWCR.

3. Senate Consideration of the Third Protocol to the United States/United Kingdom Tax Convention

As a result of the Senate's action in attaching the Church reservation to the proposed US/UK Tax Convention, the treaty was resubmitted to the United Kingdom. Before the treaty was approved by the United Kingdom, additional negotiations took place resulting in the Third Protocol to the Treaty. Along with other changes, the Third Protocol recognized the Church reservation. For further discussion see B.2., *infra*.

The Senate gave its advice and consent to the Third Protocol by a vote of 98 yeas and 0 nays. Ex. 36B, BJA-193 at 228.

The federal policy to allow WWCR is reinforced by the actions of the United States and the United Kingdom on the Third Protocol. The course of conduct of both countries indicates an understanding that the policy of the United States was to allow the States to use WWCR. These actions demonstrate awareness of the "problem" and the decision to curtail, at most, federal use of the WWCR method and not to curtail subnational use.

4. Congressional hearings subsequent to the negotiation of the United States/United Kingdom Tax Convention

The existence of federal policy is further established by Congressional activities contemporaneous with and subsequent to the US/UK Tax Convention. Despite numerous legislative proposals concerning WWCR, Congress refused to enact any prohibitions on the States' use of it.[5] In 1977 and 1978, while the Senate was considering the US/UK Tax Treaty, hearings were held on federal regulation of State income taxation of interstate and foreign commerce. *Interstate Taxation, S. 2173: Hearings before the Senate Committee on the Judiciary*, 95th Cong., 1st and 2d Sess. (1977-1978). Stip. ¶ 37g, BJA-24.

In 1980, the Senate Finance Committee held hearings on S. 983 and S. 1688. The primary purpose of these bills was to prohibit State use of WWCR. *State Taxation of Interstate Commerce and Worldwide Corporate Income, 1980: Hearings on S. 983 and S. 1688 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance*, 96th Cong., 2d Sess. (1980). Stip. ¶ 37e, BJA-24.

Again in 1986, a Subcommittee of the Senate Finance Committee held hearings on S. 1113 and S. 1974, bills which were specifically introduced to limit the States' ability to use WWCR. *Hearing before the Subcommittee on Taxation and*

---

[5] A list of some of the bills which have been introduced in Congress which would have affected the States' use of worldwide combined reporting is set forth at ¶ 38 of the Barclays Joint Stipulation, BJA-24. None of these bills has been enacted. A list of the hearings which have been held by various Committees of Congress is set forth at ¶ 37 of the Barclays Joint Stipulation, BJA-23.

Debt Management of the Congress on Finance on S. 1113 and S. 1974, 99th Cong., 2d Sess. (September 29, 1986). Second Stip. ¶ 37i, BJA-47.

This course of conduct indicates Congress was aware of the States' use of WWCR and acquiesced in its use.

B. The Actions Of The Executive Branch Are Evidence Of A Policy Of The Federal Government To Permit The State Taxes Here At Issue

The bilateral tax agreements establish a federal policy permitting states' use of WWCR. A consistent federal policy is also evidenced by the conduct of the Executive Branch when negotiating income tax conventions with foreign countries. These treaties show that all parties were aware of the concerns surrounding WWCR and understood that federal policy was to restrict only national, and not subnational, use of WWCR.

1. The positions of the Executive Branch in negotiating bilateral tax treaties are evidence of the policy of the United States

In 1977 the Executive Branch published a Model United States Income Tax Treaty. Ex. 45, BJA-560. It revised this document in 1981. Stip. ¶ 45, BJA-37. In the statement of taxes covered, the treaty excludes subnational taxes. In June of 1979 at the *Hearing Before the Committee on Foreign Relations of the United States Senate on Six International Tax Treaties and Protocols*, in response to a question by Senator Church, Assistant Secretary of Treasury for Tax Policy, Donald C. Lubick, explained why State taxes were not included:

> "These local U.S. taxes are not covered because it is unlikely that the United States would consent to the ratification of any treaty provision that restricted the rights of the various states to impose their own taxes." Ex. 37H, BJA-436 at 438.

In transmitting the Income Tax Convention with the Union of Soviet Socialist Republics to the Senate Foreign Relations Committee, the State Department made a similar statement regarding "Taxes Covered" in the Technical Explanation:

> "The taxes imposed by the Union Republics of the Soviet Union (comparable to states of the United States) are not covered by the Convention because, *in keeping with past U.S. policy the taxes of the state and local governments of the United States* are excluded from the scope of the Convention, except for purposes of Article X (Nondiscrimination)." (Emphasis added.) Second Stip. ¶ 60, BJA at 49, Ex. 60, p. 18.

The long debate concerning the US/UK Tax Convention further evidences that United States policy permits WWCR. In transmitting the proposed treaty to the Senate for its advice and consent, the Executive Branch noted, "A second new provision is found in paragraph 4 of Article 9 (Associated Enterprises). This provision represents the <u>first</u> <u>attempt</u> to bind State and local taxing authorities by a substantive provision of the treaty (other than non-discrimination)." (Emphasis added.) Letter of Submittal, June 8, 1976, 3 Tax Treaties (CCH) ¶10,938.

After the United States Senate had approved the proposed treaty, with the Church reservation, members of the Executive

Branch negotiated the Third Protocol to the Treaty to reflect the action of the Senate. According to Treasury, one of the changes made to the treaty by the Third Protocol related to the North Sea permanent establishment rules. The British viewed the North Sea change as a concession by the United States in exchange for British acceptance of the United States reservation on Article 9(4). Reply of Donald C. Lubick to question posed by Senator Church, Ex. 37H, BJA-436 at 437.

Other members of the international community subsequently understood that United States policy did not prohibit the States' use of WWCR. In 1978, George S. Vest, Assistant Secretary of State for European Affairs, and Francois de Laboulaye, Ambassador of France, set forth the position of their respective governments on including a treaty prohibition on the States' use of WWCR as follows:

> It is understood that the Senate of the United States has not consented to any limitation on the taxing jurisdiction of the states by treaty and that a provision which would have restricted the use of unitary apportionment in the case of United Kingdom corporations was recently rejected by the Senate. The Government of France continues to be concerned about this issue as it affects French multinationals. If an acceptable provision on this subject can be devised, the United States agrees to reopen discussions with France on this subject. Ex. 43, BJA-480 at 481-482.

In addition, Donald C. Lubick of the Department of the Treasury, in a letter dated April 22, 1980, advised Barber B. Conable, Jr. of the House of Representatives, with respect to the French Treaty:

> The unitary apportionment issue was discussed at length during the negotiation of the recent Protocol to the U.S.-French income tax Convention. The French negotiators accepted the fact that, on the basis of our experience with the U.K. treaty, the Treasury was unable to achieve ratification of a Protocol limiting unitary apportionment. Ex. 46C, BJA-568 at 570.

Further, in 1980, Allan J. MacEachen, Deputy Prime Minister and Minister of Finance of Canada, and G. William Miller, Secretary of Treasury of the United States, exchanged notes concerning Canada's desire for a limitation on the States' use of WWCR. The note of G. William Miller stated in part:

> It is understood that the Senate of the United States has not consented to any limitation on the taxing jurisdiction of the states by a treaty and that a provision which would have restricted the use of unitary apportionment in the case of the United Kingdom corporations was recently rejected by the Senate. Canada continues to be concerned about this issue as it affects Canadian multinationals. If an acceptable provision on this subject can be devised, the United States agrees to reopen discussions with Canada on this subject. Ex. 42, BJA-477 at 478.

There is no confusion in the international community and the Executive Branch about United States policy. That policy permits States to use WWCR.

2. The statements of the Executive Branch on proposed federal legislation, introduced after this Court's decision in *Container*, to prohibit State use of WWCR is evidence of the Executive's recognition of accepted United States policy

Subsequent to this Court's decision in *Container*, the Executive Branch initiated efforts in 1985 to obtain passage of federal legislation which would "[e]ffect a requirement that multinationals be taxed by states only on income derived from the territory of the United States ('the water's edge of requirement')." Ex. 36A, BJA-191. As way of explanation, President Reagan stated, "We hoped that by this time these principles would have been enacted by the various states that have unitary taxation. Since states have not universally accepted these principles, I am instructing the Secretary of the Treasury to initiate the process of crafting Federal legislation to incorporate these principles into law . . ." Ex. 36A, BJA-191.

The Executive Branch recognized: 1) the law did not require the States to forgo the use of WWCR and 2) the need to accomplish the desired change by the action of the Congress. This is not evidence of a United States policy against the States' use of WWCR, but rather evidence of an aspiration that United States policy be changed.

In September of 1986, the bill the President requested, S. 1974, came to a hearing. At the Hearing Before the Subcommittee on Taxation and Debt Management of the Senate Finance Committee on S. 1113 and S. 1974, Roger Mentz, Assistant Secretary (Tax Policy) Department of Treasury, testified as follows:

In general, S.1974 would prohibit states from levying corporate income taxes on a worldwide unitary basis, . . .

I am pleased to report that, since the introduction of the legislation, Idaho, New Hampshire, Utah and, on September 5, California, have enacted "water's edge" legislation. The Administration applauds these states' actions. These state legislative developments go a long way toward resolving the difficult unitary tax issue. Moreover, they illustrate the successful operation of the Federal system. (Emphasis added.) . . .

We have not, however, reached the end of the road with respect to this issue. . . . We believe, however, that such significant progress has been made that restrictive Federal legislation is not warranted at this time. Ex. 37I, BJA-440-441.

The Executive Branch was aware that the policy of the Federal Government permitted the States to use WWCR and that voluntary action was an appropriate and constitutionally permitted way to accommodate the needs of both the Federal Government and the States.

3. The Executive Branch's reservation to the model tax conventions of the Organization for Economic Cooperation and Development (OECD) is evidence of the policy of the United States to permit the States to use WWCR

In *Wardair*, this Court considered the significance of the adoption by an international organization of a model agreement which would have treated national and subnational taxes in an identical manner. This Court held that the action of the international agency was of no evidentiary value in

determining whether there was a policy of the United States against the State tax at issue in *Wardair* because the United States had taken no action to endorse, adopt, or enact the policy.

In 1963, and again in 1977, the Committee of Fiscal Affairs to the Council of the OECD published a Model Double Tax Convention on Income and On Capital. Ex. 44, BJA-484-559. The Executive Branch of the United States announced its reservation to that portion of the Model Treaty which made it applicable to subnational taxes. Ex. 44, BJA-484 at 501. This expressed reservation is evidence of federal law as it existed.

Under the *Wardair* analysis, the OECD Model Treaty cannot establish a United States policy prohibiting the State tax at issue because the United States did not endorse, adopt, or enact the policy. To the contrary, the Executive Branch's announcement of a reservation to the OECD Model Treaty evidences the United States policy not to restrict subnational taxation and, therefore, to permit the States to use WWCR.

CONCLUSION

The actions of both the Executive Branch and the Legislative Branch of the Federal Government provide clear and convincing evidence that the United States' policy is to permit the States to use WWCR. In many respects, the evidence present in these cases is more compelling than that relied upon by this Court in *Wardair*.

Use of WWCR by California and the other States is constitutionally permissible and the judgments of the California courts should be affirmed.

Dated: January 19, 1994

Respectfully submitted,

M.K. Heidi Heitkamp
North Dakota Attorney General
Counsel of Record
Office of the Attorney General
State Capitol
600 E. Boulevard
Bismarck, ND 58505
Attorney for Amici

Of Counsel:

Donnita A. Wald
Assistant Attorney General
State Tax Department
State Capitol
600 E. Boulevard
Bismarck, ND 58505